

## REAL ESTATE CORPORATIONS: SALE OF ALL REALTY AUTHORIZED BY GENERAL PURPOSE CLAUSE

*Eisen v. Post*, 3 N.Y.2d 518, 146 N.E.2d 779 (1957)

Plaintiff was the holder of fifty per cent of the outstanding shares of a New York "real estate" corporation, whose sole assets were a sub-lease of a theatre and the chattels therein. These assets were sold by the directors in furtherance of a plan to distribute the proceeds of the sale to the shareholders in proportion to their holdings. Plaintiff brought an action to set aside the sale, based on section 20 of the New York Stock Corporation Law which authorizes a corporation to sell, lease or exchange its property and assets but "if such sale, lease or exchange is not made in the regular course of business of the corporation and involves all or substantially all of its property" it "shall not be made without the consent" of either all of the stockholders "given in writing without a meeting" or two thirds of the stockholders "at a meeting."

The plaintiff's chief contention was that, although the defendant corporation was, by its charter, authorized to buy, sell and generally deal in real estate, this sale could not be considered in the regular course of business because the corporation had never actually engaged in the business of buying and selling real estate and that the term "regular course of business" must be construed to mean the business in which the corporation had actually engaged, *i.e.*, the leasing and operation of the theatre.

The New York Court of Appeals in reversing the appellate division's decision in favor of the plaintiff said:

If in view of the purposes and objects for which the corporation was created the particular sale may be regarded as one in the normal and regular course of business of the corporation, section 20 is inapplicable . . . . Stated conversely, if the sale is such as to render the corporation unable, in whole or in part, to accomplish the purposes or objects for which it was incorporated, section 20 is applicable . . . .<sup>1</sup>

This interpretation of section 20 is not new to the field of corporation law in New York<sup>2</sup> nor is it a new approach generally.<sup>3</sup> However there was a split of authority in the appellate division. In *Strauss v. Midtown Enterprise, Inc.*,<sup>4</sup> and again in *Epstein v. Gosseen*,<sup>5</sup> the appellate division held that a sale or a contract for the sale of all the corporate realty by a corporation organized for the sale of real estate does not require the consent of the shareholders because section 20 did not apply to such organizations;

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<sup>1</sup> *Eisen v. Post*, 3 N.Y.2d 518, 146 N.E.2d 779 (1957).

<sup>2</sup> JACOBS, STOCK CORPORATION LAW 163 (1949).

<sup>3</sup> Annot., 9 A.L.R.2d 1312 (1950); 14a C.J., *Corporations* §2416 (1921).

<sup>4</sup> 60 N.Y.S.2d 601, *aff'd*, 270 App. Div. 837 (1945).

<sup>5</sup> 235 App. Div. 33, 256 N.Y.S. 49 (1932).

but *In the Matter of Hodes*,<sup>6</sup> a case with almost the same fact pattern as the principal case, the opposite conclusion had been reached.

In spite of the language to the effect that section 20 did not apply to real estate corporations it is clear that the question before this court was whether this sale constituted a transaction in the regular course of business. The majority's affirmative answer was based on the conviction that any operation expressly authorized by the certificate of incorporation would be in the regular course of business.<sup>7</sup>

Judge Fuld, in his dissent, stated that section 20 not only applied to the real estate corporation but:

The "business" of a corporation, its "regular course of business," just as that of a partnership or an individual, is the business upon which it is actually engaged, not the business which it was originally authorized to carry on.

He further thought it was significant that the statute referred not to what the corporation's charter empowered it to do, but to its "regular course of business." Of equal importance, he felt, was the tendency of the shareholder to invest in a particular corporation on the basis of the business which the corporation is actually conducting, not the business it may be authorized to pursue.

These arguments lack merit. Basically, a corporation is a purely artificial body created by law. It is authorized to act only in accordance with the law of its creation and that law is its certificate of incorporation and the statutes of the domiciliary state. The certificate of a corporation and its by-laws or regulations fix the rights of the shareholder. Once these rights are fixed, they cannot be changed except in the manner prescribed by statute.<sup>8</sup> Under the present theory of corporate organization a person who becomes a shareholder enters a contractual relationship with the corporation and his contractual rights are confined to those rights in the certificate and by-laws<sup>9</sup> regardless of what he supposes them to be.

In deciding as it did, the court of appeals followed what seems to be the most logical line of decisions,<sup>10</sup> for as the court said in *Painter v. Brainard-Cedar Realty Co.*:<sup>11</sup>

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<sup>6</sup> 278 App. Div. 803, 104 N.Y.S.2d 206 (1951).

<sup>7</sup> *Wattley v. National Drug Store Corp.*, 122 Misc. 533, 204, N.Y.S. 254, *aff'd mem.*, 208 App. Div. 836, 204 N.Y.S. 956 (1924). *Accord*, *Thayer v. Valley Bank*, 35 Ariz. 238, 276 Pac. 526 (1929); *Traer v. Lucas Prospecting Co.*, 124 Iowa 107, 99 N.W. 290 (1904); *State v. Western Irrigating Canal Co.*, 40 Kan. 96, 19 Pac. 349 (1888); *Peters v. Waverly Waterfront Imp. Co.*, 113 Va. 318, 74 S.E. 168 (1912); *Wilson v. Miers*, 10 C.B. (N.S.) 348, 142 Eng. Repr. 486 (1861).

<sup>8</sup> N.Y. STOCK CORP. §§35-40.

<sup>9</sup> BALLANTINE, CORPORATIONS §18 (Rev.ed. 1946).

<sup>10</sup> *Supra* note 3; *Jeppi v. Brockman Holding Co.*, 34 Cal.2d 11, 206 P.2d 847 (1949); *Pollack v. Adwood Corp.*, 321 Mich. 93, 32 N.W.2d 62 (1948).

<sup>11</sup> 29 Ohio App. 123, 129, 163 N.E. 57, 59 (1928).

If the position of the defendant (corporation) is correct, it could not carry on that business (for which it was formed) by dealing in the only property it had yet acquired except by concurrence of three-fourths of the stockholders. That is to say, while a mere majority of the directors and a majority of the stockholders might dissolve the corporation . . . and compel the sale of the property, three-fourths of the stockholders were requisite to the transaction of the very business it was incorporated to perform.

Had the dissenting opinion been adopted a real estate corporation holding only one piece of property, which it was renting because of an unfavorable market, would be required to call a meeting of the shareholders before a sale of the property could be safely consummated.

It may be noted here that the approach taken in respect to real estate corporations has also been applied in cases involving a corporation organized for purposes other than dealing in real estate generally, but authorized in connection with its corporate activities to purchase and sell real estate.<sup>12</sup> In these cases as well as the principal case the test used by the courts was:

. . . not the amount involved, but the nature of the transaction, whether the sale is in the regular course of business of the corporation and *in furtherance of the express objects of its existence*, or something outside the normal and regular course of business.<sup>13</sup> (Emphasis added.)

The emphasized phrase above clearly refers to those objects and purposes expressly set out in the certificate of incorporation. In determining what sales were in the regular course of business in *Wattley v. National Drug Stores Corp.*,<sup>14</sup> the court said "we need go no further than the specified powers contained in the certificate which undoubtedly authorize such sale."<sup>15</sup> Again in *Petition of Avara*<sup>16</sup> the court looked to the certificate of incorporation and, finding that the directors in addition to operating a knitting mill in New York were authorized to "do all acts and things as may be necessary, convenient, or incidental to its business,"<sup>17</sup> held that a sale of the mill in contemplation of a move to another state was in the regular course of business and not in violation of section 20.

With the all inclusive general purpose clause of the modern corpo-

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<sup>12</sup> *Wattley v. National Drug Store Corporation*, *supra* note 7 (retail drug business with general authorization to sell its real property); *Thayer v. Valley Bank*, *supra* note 7 (general authorization of bank to deal in real estate); *Matter of Miglietta*, 287 N.Y. 246, 39 N.E.2d 224 (1942); *Matter of Timmis*, 200 N.Y. 177, 93 N.E. 522 (1910); *Tuttle v. Junior Bldg. Corp.*, 227 N.C. 146, 41 S.E.2d 365 (1947) (authorized to purchase, develop and sell one particular parcel of real estate).

<sup>13</sup> *Matter of Miglietta*, *supra* note 12, at 254.

<sup>14</sup> *Supra* note 7.

<sup>15</sup> *Id.* at 535.

<sup>16</sup> 5 Misc.2d 817, 144 N.Y.S.2d 204 (1955).

<sup>17</sup> *Id.* at 818.

ration<sup>18</sup> there are few transactions which are not permitted by directorial action alone. Herein lies the principal objection to the test laid down by the court in *Eisen v. Post*. If literally followed there are few transactions to which the statute will apply.<sup>19</sup> In addition there is no guarantee that the directors will apply the proceeds of the sale to the furtherance of the business or remain in business at all after the sale. While it is true that the shareholders would have to approve a dissolution,<sup>20</sup> it would be too late to give them the protection contemplated under section 20.

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<sup>18</sup> As said by Lord Wrenbury in *Cotman v. Broughman*, [1918] A.C. 514, 523, "[T]he function of the (certificate) is taken to be, not to specify, not to disclose, but to bury beneath a mass of words the real object or objects of the company with the intent that every conceivable form of activity shall be found included somewhere within its terms. . . ."

<sup>19</sup> A different result is possible under OHIO REV. CODE §1701.76 (1955), which provides that a sale must be made in "the usual and regular course" of business to be exempt from the requirement of shareholder approval.

<sup>20</sup> N.Y. STOCK CORP. §§105-107.